EXHAUSTED FARMS AND EXHAUSTING TAXATION

In its recent report, the Commission upon Country Life calls impressively to the attention of Congress "the widespread continuing depletion of soils," and finds in this fact one of the leading conditions bearing adversely upon rural living.

It is most fortunate that this fact of progressive deterioration has finally achieved authoritative recognition. Economists—some of them—have, on purely theoretical grounds, insisted that such deterioration must be taking place, but it has been beyond their reach to support the doctrinal analysis by appeal to a first-hand investigation of the concrete facts. Even were there, then, in the report of the commission nothing further than the announcement of this one fact, the commission would have well justified its existence.

But it is unfortunate that the commission has done little toward explaining the momentous fact which it reports. Bad farming may, it is true, serve—so far as it goes—as an explanation for the case; but why is there this bad farming? Native ignorance or faulty education might, of course, stand as ultimate cause, if only it were true that other rural populations rank above our own in intelligence.

But is there not a more satisfactory explanation? May it not indeed be true that present conditions are such as to stimulate a more and more rapid deterioration of the farms in proportion as the owners are more and more intelligent? Is ignorant husbandry the cause for which we are in search?

For decades the evils of the general property tax have been the occasion of denunciation on the part of all thoughtful students of tax problems. Broadly speaking, the general property tax is the central and almost exclusive feature—or in any event the characteristic and prevailing feature—of our American system of taxation. And on the face of it the system does not appear to be an unfair one: Let each man pay according to his property. To the native and naïve common-sense of men this

appeals as self-evident justice: legislatures will mostly hear of nothing else.

Thus it has not greatly profited the economists to point out that this general property tax is not truly general at all—that it fails lamentably, almost completely, of reaching more than real estate and tangible personalty—reaches, indeed, only a small part of the tangible personalty—and that in effect it is in no sense a tax on property in general, but only a tax on real property. To the occasional recommendation that the tax upon personalty be abandoned in its entirety as impracticable and as, in actual working, iniquitous and unequal, and that substitute taxes be contrived, legislatures have almost uniformly replied by further enactments in the direction of strengthening the present tax administration in its attempt to make the tax upon personalty a reality rather than a legal fiction. That these methods have so far failed of their purpose has not greatly mattered: the tax ought to work; it will some day work; it must, it shall: hope springs eternal. At all events the evil from escaping personalty seems hardly possible of cure by the legal exemptions of personalty.

Perhaps the economists ought not to have placed their case precisely as they have placed it. But, surely, if any tax will not and cannot work, it is a bad tax, no matter how nearly ideal it might be if only it could be made effective. If, then, the general property tax offers no hope of ever being more than a real estate tax, there appears to be only the alternative of abandoning the tax entirely or of making it in law, as it is in practice, a mere tangible-property tax or a realty tax. But, as we shall later see, a tax that burdens realty and exempts personalty has some disadvantages of so serious a sort as to recommend its abandonment rather than its fractional retention.

And yet it may be true that the present ineffectiveness of the general property tax does not rest in any inherent and incurable weakness, but only in the fact that, *as the main tax or the only tax* of a fiscal system, it cannot work—that it is bad purely for the reason that it is not properly supported and supplemented by other taxes—that its ineffectiveness is therefore entirely unneces-

sary and gratuitous—that it might work if only it were given a fair chance. This needs looking into.

It is now generally agreed that the burden of taxation should reflect and express the ability to pay. It is indeed upon this principle that the property tax is advocated: Let each pay according to his wealth. But the ultimate difficulty here is that the possession of wealth is leagues away from measuring tax-paying capacity. An easy computation will make this clear. The total wealth of the country is fixed by the statisticians at about $120,000,000,000—not far from $1,300 per capita of population. The bread-winners of the country are not far from 30,000,000 in number. The aggregate yearly income of the country—the summed-up national product—is somewhere from $25,000,000,000 to $30,000,000,000 per year.

Now, assuming that the average rate of interest on wealth is 5 per cent.—perhaps a liberal estimate—and taking no account of the fact that much of the wealth, e. g., furniture and automobiles, does not earn income in any ordinary sense, 5 per cent. of the $120,000,000,000 represents that portion of the national dividend which arises from property as investment. Therefore we conclude that something like $5,000,000,000 out of the total of $25,000,000,000 or $30,000,000,000 of national income are to be regarded as derivative from accumulated wealth, property. This means, then, that our present tax—the property tax—reaches not over one-fifth of the tax-paying capacity of the nation, and that the burden that should be distributed over the entire income is concentrated upon that one-fifth of the income representing the earning power of property. And, allowing also for the fact that personalty mostly evades its proportion of the burden, it results that the land, representing about one-tenth of the tax-paying power of the country—the land wealth—pays taxes for the whole.

But for our present purpose the important fact is that precisely in this failure of the tax system to reach the non-property income is the reason that only a portion of the property income is reached. Such wealth as does get taxed is taxed at from 1 to 2 per cent. of its actual market value. Taking the earning power to

run even as high as 6 per cent., the tax appropriates, therefore, from one-sixth to one-third of the income. The temptations to evasion are evidently too strong for frail human nature to resist: the premiums upon dishonesty and the penalties upon honesty are over-great. That some men evade is the very reason—and is measurably a justification—for all the rest attempting to evade. If others do not pay, you and I ought not—and do not.

That is to say, the high rate of taxation, due to centralizing all the tax burdens upon property alone, is just the reason why only a share of that property can be made to contribute. The first condition, then, to an effective general property tax is to make over the tax system in general. If personal property ever comes to pay its fair share, this will be only when property in general does not have to pay indefinitely more than its fair share. And, even then, it may well turn out to be true that personal property, and especially the intangible elements of it, will have to be reached under administrative methods other than local search and appraisal. But this particular problem is, in truth, aside from our immediate purpose, as is also the problem of the precise method of reaching credits and of avoiding the double taxation so prone to associate itself with the taxation of credit relations.

The discussion has thus far doubtless taken things somewhat in the large, and vaguely, but nevertheless not inaccurately for our present purpose. And for this purpose, also, it need not matter that other taxes than property taxes are imposed, as, for example, excise and customs duties, which do in some measure burden those incomes derived from personal earning power. Our concern is solely with what the general property tax is doing and with its distribution over the field of tax-paying capacity. It may indeed be urged that the burdens upon real estate owners are in some share passed along in higher prices to society in general: possibly so, though probably not in large measure. And, on the other hand, it is equally to be said that excise and customs burdens are in large part borne by real-estate owners.

But however this may be, it does not matter here: our interest does not lie with the question of justice as between different tax

bearers, but only with the relative burdens upon different sorts of property, and with the effects of these inequalities, not upon the owners, but upon the property. It may or may not be true that to burden the property unequally is to burden unequally the owners of the property: this will shortly require examination. Our problem is—why is the fertility of the farm suffering? No matter about the owners simply as such—and no matter, for our purposes, that the lawyer with $10,000 a year of professional income pays nothing, or pays only indirectly, while an equal income derived from property suffers a burden of from $2,000 to $4,000. We want to know simply how far the cultivation and up-keep of *land* must be affected by the fact that landed investment has to bear burdens from which other investments are free. What is the effect upon husbandry of a property tax that does not reach the non-land varieties of property? Thus all our talk about the national income is relevant only to explain the source and the cause of the pressure by virtue of which all property—excepting that which is tangible, and much of this—comes to evade taxation.

In truth, if the grievance were really one of alleged injustice to land-*owners,* it would fall far short of the making. True, the tangible forms of property are burdened out of all proportion to other property, and still further out of proportion to other tax-paying capacity; but, paradoxically enough, this fact implies no injustice to the owner of the burdened property.

For note: real property has value on exactly the same basis that any other income-bearing or dividend-paying wealth has value—in proportion, that is, to its net earning power. The market value of any source or payer of income is merely the present worth of its expected future earning power. Its successive returns are capitalized into current market value. It is earning power that explains value and not value that explains earning power. Not only stocks and bonds but farms and houses derive their value from their dividends. Knowing the going rate of interest and the earning power of any item of property, the market value is easily deduced by a simple mathematical computation—a process of discount of the series of earnings into a present worth.

Now apply this principle to the farm. By precisely so much as the tax is higher than the tax on other investments yielding equal income, so much is the value of the farm diminished; at so much the lower price is the investor and buyer able to purchase the property. The ultimate fact is, therefore, that the owner of the property does not pay the tax—he only seems to. The tax was capitalized to lessen the size of his investment. It is as if he had purchased the property subject to a mortgage or to a permanent rent charge. He pays the interest, or the rent charge, or the tax, as an equivalent and an offset for the greater purchase price that he otherwise would have paid. He is paying taxation in place of interest. In justice, therefore, he can have no claim to have the tax remitted. To cancel it would be to make to him a free gift of the present worth of the tax incumbrance; so to impose a new tax is in effect and *pro tanto* an act of confiscation.

The evil, then, of our almost exclusive taxation of real property—or the evil of the relatively high rate of charge on this property—is not to be found in the direction of injustice to the owner of this property. The evil lies in the inevitable tendency toward the exhaustion of the fertility of our land—in the pressure which is being exerted to induce or to compel the exhaustion of our agricultural resources. But just how does this work out?

The traditional political economy teaches that taxes upon land or upon the rental income from land do not shift; they remain with the land-owners, instead of ultimately passing over to consumers in the form of enhanced prices upon products. If, it is said, a tax is to shift, it must do so through its effect to change the prices of the product produced upon the land. Any problem in the shifting and incidence of taxation is a problem of market prices—a question of the modification of market value worked by the tax. Now, no rise in market price can occur otherwise than by an increase of the demand for the product or by a decrease in the supply. Evidently no appreciable effect can be exerted by a land tax to modify the social need for food supplies and for raw materials. If anything in the way of a rise of price is to take place as a result of the tax, this must ensue through the reduction of the supply of agricultural products. But will the tax upon land values or land rents drive any land out of cultiva-

tion? Whither can it go and what becomes of it then? If the price is raised, less product will be purchased by the consuming public and some lands will be left competing for those tenants assumed to have been displaced. And if the tenants are required to pay higher rents to make up to the landlord his extra tax, the tenants cannot sell all their product, and again it must result that some land will remain uncultivated. It follows that this potential competition by tenantless land for tenants is just the reason that none of the land can ever come to be tenantless. If then the tenants cannot shift the tax to the consumer, the landlord cannot shift it to the tenant and must bear the tax himself. He cannot afford to let his land lie idle. The half-loaf is better than no bread: he would better get some rent from his land than get none.

It is, however, generally agreed that the case is otherwise with taxes upon machinery or the buildings or the raw materials in manufacturing industries. If you tax the manufacturer's supplies, he must sell at a correspondingly high price or not find it worth his while to produce. If you tax his machinery, he must decline to instal it otherwise than upon terms of selling the product correspondingly higher. True he will then sell less product: it is indeed because, under the tax, he will put in less machinery, that he will have less product for sale, and so can market it at the higher price. So, likewise, if his machinery or his buildings were already installed when the tax was imposed, the operation of the principle would be none the less inevitable, though requiring more time to manifest itself fully. When the necessity for replacement presents itself he will find that it is not worth his while to keep up his entire stock of equipment; he will allow his machinery to run down or to wear out through depriving it of repairs and of up-keep. The supply of product must finally fall, precisely as if the tax had been imposed at the inception of his undertaking. Similarly with buildings: to tax any particular manufacturing industry more highly than others is to enforce the more or less rapid and more or less complete transfer of its capital into non-taxed lines of production.

Not so, however, it is urged, with land. Land, unlike machinery, was always here and is here for always. The quali-

ties of the soil, as they were uncreated by man, are asserted to be inexhaustible by him. As Ricardo put it, years ago, these qualities are "original and indestructible." And, following Ricardo, Bastable, the leading English writer upon taxation, says that the case with land is quite other than with capital:

> Unlike land, it can be indefinitely increased by human foresight and prudence, having as a chief inducement the return to be obtained by investment. Taxation on interest . . . . is therefore a direct discouragement to saving.

And Professor Carver writes:

> All goods excepting land "are perishable and reproducible while land is not." . . . . These distinctions are important because important conclusions as to public policy depend upon them. . . . . A tax on land . . . . has a different effect from a tax on an article which is being produced, worn out, and reproduced by human effort. A tax on the latter class of articles has the effect of discouraging that effort and, consequently, of reducing the supply, whereas a tax on land does not affect the supply in the same way. . . . .

But in point of fact, it is just at this point that the traditional theory breaks down. Nothing is really simpler than to wear out a farm. It is the farmer's easy and only way of placing himself among the happy brotherhood of the untaxed. He can accomplish this if he will; he will accomplish it, if only he has the good sense to see his opportunity. Instead, then, of stupidity being the effective cause of soil depletion, stupidity is the only safeguard against it. For it is clear that to crop and to withhold up-keep of fertility—the process called "skinning"—or to slaughter the timber, is a well-recognized way of marketing a land value; it is as easy as selling out to an insurance company by burning one's property. Rural New England in its approximate entirety stands witness to this fact; tenant farming everywhere is its illustration; the progressive exhaustion of our continental heritage of fertility is a direful example; stupid or improvident farming, under the stimulus of a stupid application of the stupid general property tax principle, must turn over to posterity an exhausted farm area. If a one-thousand-dollar investment in land improvements brings a gross return of fifty dollars but is subjected to a tax reduction of ten dollars,

while the same one thousand dollars invested in merchandising will pay fifty dollars free of tax, the wise farmer will refuse to make the improvement. And if it happen that the land was fertile to begin with, the same principle holds: the more quickly the fertility can be taken out—marketed under the guise of agricultural product—the earlier the owner puts himself in the way of getting a net return of 5 per cent. upon his money instead of 4 per cent. That is to say, his land under these conditions is worth more to wear out than to keep up.

From all this, further conclusions would follow, if only there were time and space to permit. The facts and the analysis already presented have something to say for the problems of income taxes, habitation taxes, business taxes, corporation taxes, and inheritance taxes; something, also—though vaguely and indirectly—for excise and customs taxes. But all these would be other stories. Something, also, would follow for the illumination of the single-tax programme, so far as this programme intends the further burdening of fertility values, as against location values—and especially so far as rural lands are concerned in contrast with urban lands. But this, also, would be outside our present purpose. And something, also—of perhaps greater import—might be said of the absolute absurdity anywhere and everywhere of the attempt to tax the values of property instead of rents. For the very fact that you tax a value so far deprives you of the basis of the tax. And the yet more important application lies near at hand as to the possibility of reaching franchise values under the property principle, by making the tax a percentage, a fraction, of their property-values, in place of proceeding directly against the rental as a step in the attempt to appropriate the entire public-service value. For obviously, if the tax upon these values is adapted to turn over to the state the entire equivalent of the privilege enjoyed, it must result that there can be no value to be taxed. A wise climber never saws off the limb on which he is sitting. But because these stories also are other stories they are no part of the present story.

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